

**PROTOCOL AMENDING THE CONVENTION BETWEEN  
THE GOVERNMENT OF THE UNITED STATES OF AMERICA AND  
THE GOVERNMENT OF THE DEMOCRATIC SOCIALIST REPUBLIC OF  
SRI LANKA FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE  
PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON INCOME  
SIGNED AT COLOMBO MARCH 14, 1985**

The Government of the United States of America and the Government of the Democratic Socialist Republic of Sri Lanka, desiring to conclude a Protocol to amend the Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income signed at Colombo on March 14, 1985 (hereinafter referred to as “the Convention”), have agreed as follows:

**Article I**

Paragraph 3 of Article 1 (Personal Scope) of the Convention shall be deleted and replaced with the following:

“3. Notwithstanding any provision of the Convention except paragraph 4 of this Article, a Contracting State may tax its residents (as determined under Article 4 (Resident)), and by reason of citizenship may tax its citizens, as if the Convention had not come into effect. For this purpose, the term “citizen” shall include a former citizen or long-term resident whose loss of such status had as one of its principal purposes the avoidance of tax (as defined under the laws of the Contracting State of which the person was a citizen or long-term resident), but only for a period of 10 years following such loss.”

A new paragraph 5 shall be added to Article 1 (Personal Scope) of the Convention as follows:

“5. Notwithstanding the provisions of subparagraph 2(b):

(a) the provisions of Article 26 (Mutual Agreement Procedure) of this Convention exclusively shall apply to any dispute concerning whether a measure is within the scope of this Convention, and the procedures under this Convention exclusively shall apply to that dispute; and

(b) unless the competent authorities determine that a taxation measure is not within the scope of this Convention, the nondiscrimination obligations of this Convention exclusively shall apply with respect to that measure, except for such national treatment or most-favored-nation obligations as may apply to trade in goods under the General Agreement on Tariffs and Trade. No national treatment or most-favored-nation obligation under any other agreement shall apply with respect to that measure.

(c) For the purpose of this paragraph, a “measure” is a law, regulation, rule, procedure, decision, administrative action, or any similar provision or action.”

**Article II**

Subparagraph (b) of paragraph 2 of Article 2 (Taxes Covered) of the Convention shall be deleted and replaced by the following:

“(b) In the United States: the Federal income taxes imposed by the Internal Revenue Code of 1986, but excluding the accumulated earnings tax, the

personal holding company tax, and social security taxes (hereinafter referred to as “United States tax”).”

### **Article III**

Subparagraph (f) of paragraph 1 of Article 3 (General Definitions) of the Convention shall be deleted and replaced by the following:

“(f) the terms “enterprise of a Contracting State” and “enterprise of the other Contracting State” mean respectively an enterprise carried on by a resident of a Contracting State, and an enterprise carried on by a resident of the other Contracting State; the terms also include an enterprise carried on by a resident of a Contracting State through an entity that is treated as fiscally transparent in that Contracting State;”

The following new subparagraph (j) shall be added to paragraph 1 of Article 3 (General Definitions) of the Convention:

“(j) the term “qualified governmental entity” means:

(i) any person or body of persons that constitutes a governing body of a Contracting State, or of a political subdivision or local authority of a Contracting State;

(ii) a person that is wholly owned, directly or indirectly, by a Contracting State or a political subdivision or local authority of a Contracting State, provided (A) it is organized under the laws of the Contracting State, (B) its earnings are credited to its own account with no portion of its income inuring to the benefit of any private person, and (C) its assets vest in the Contracting State, political subdivision or local authority upon dissolution; or

(iii) a pension trust or fund of a person described in subparagraphs (i) or (ii) that is constituted and operated exclusively to administer or provide pension benefits described in Article 19 (Pensions, Social Security, and Child Support Payments);

provided that an entity described in subparagraphs (ii) or (iii) does not carry on commercial activities.”

Paragraph 2 of Article 3 (General Definitions) of the Convention shall be deleted and replaced by the following:

“2. As regards the application of the Convention at any time by a Contracting State, any term not defined therein shall, unless the context otherwise requires, or the competent authorities agree to a common meaning pursuant to the provisions of Article 26 (Mutual Agreement Procedure), have the meaning which it has at that time under the laws of that State for the purposes of the taxes to which the Convention applies. For the purposes of this paragraph, the meaning given to any term under the laws of that State relating to the taxes to which the Convention applies shall prevail over any meaning given to that term under any other laws of that State.”

### **Article IV**

Subparagraph (b) of paragraph 1 of Article 4 (Resident) shall be deleted and replaced by the following:

“(b) an item of income, profit or gain derived through an entity that is fiscally transparent under the laws of either Contracting State shall be considered to be derived by a resident of a State to the extent that the item is treated for purposes of the taxation law of such Contracting State as the income, profit or gain of a resident;”

The following new subparagraphs (c) and (d) shall be added to paragraph 1 of Article 4 (Resident):

“(c) in the case of the United States, a legal person organized under the laws of the United States and that is generally exempt from tax in that State and is established and maintained in that State either:

(i) exclusively for a religious, charitable, educational, scientific, or other similar purpose; or

(ii) to provide pensions or other similar benefits to employees pursuant to a plan

is to be treated for purposes of this paragraph as a resident of the United States; and

(d) a qualified governmental entity is to be treated as a resident of the Contracting State where it is established.”

## **Article V**

A new paragraph 8 shall be added to Article 7 (Business Profits) of the Convention as follows:

“8. In applying paragraphs 1 and 2 of this Article, paragraph 4 of Article 10 (Dividends), paragraph 5 of Article 11 (Interest), paragraph 5 of Article 12 (Royalties), paragraph 3 of Article 13 (Capital Gains) and Article 15 (Independent Personal Services), any income or gain attributable to a permanent establishment or fixed base during its existence is taxable in the Contracting State where such permanent establishment or fixed base is situated even if payments are deferred and received after the permanent establishment or fixed base has ceased to exist.”

## **Article VI**

Paragraph 5 of Article 8 (Shipping and Air Transport) of the Convention shall be deleted and replaced with the following:

“5. Profits of an enterprise of a Contracting State from the use, maintenance, or rental of containers (including trailers, barges, and related equipment for the transport of containers) used for the transport in international traffic of goods or merchandise shall be taxable only in that State.”

Paragraph 6 of Article 8 (Shipping and Air Transport) of the Convention shall be deleted and replaced with the following:

“6. For purposes of determining the maximum tax which may be imposed by a Contracting State under paragraphs 2 and 4, the following rules shall apply:

(a) the tax which may be imposed by the other Contracting State under paragraph 2 shall not exceed the lesser of the tax which may be imposed under the provisions of that paragraph and the lowest rate of Sri Lanka tax that may be imposed on the profits of the same kind derived under similar circumstances by a resident of a third State. For purposes of this subparagraph, if Sri Lanka imposes an additional amount of tax which is not covered by this Convention in place of the income tax on an enterprise resident in a third State, the amount of such additional tax shall be treated as Sri Lanka tax; and

(b) the tax which may be imposed by the other Contracting State under paragraph 4 shall not exceed the lesser of the tax which may be imposed under the provisions of that paragraph, and the lowest Sri Lanka tax burden on such income derived by a resident of any third State.

For purposes of this paragraph, Sri Lanka tax imposed on a resident of a third State shall not include tax imposed by Sri Lanka under special provisions of its statutory law, in effect on the date of signature of this Convention, on income of the kind dealt with in this Article, which special provisions are applicable only to income derived by the Government or by a government agency of a third State.”

## **Article VII**

The following shall be added at the end of paragraph 2 of Article 10 (Dividends) of the Convention:

“In the case of dividends paid by a United States Real Estate Investment Trust (REIT), the tax rate limitation in the preceding sentence shall apply instead of the rate of tax applicable under domestic law only if:

(a) the beneficial owner of the dividends is an individual holding a less than 10 percent interest in the REIT;

(b) the dividends are paid with respect to a class of stock that is publicly traded and the beneficial owner of the dividends is a person holding an interest of no more than 5 percent in any class of the REIT’s stock; or

(c) the beneficial owner of the dividends is a person that beneficially holds an interest of 10 percent or less in the REIT and the value of no single interest in real property owned by the REIT exceeds 10 percent of the value of the REIT’s total interests.”

Paragraph 3 of Article 10 (Dividends) of the Convention shall be deleted and replaced with the following:

“3. The term “dividends” as used in this Article means income from shares, mining shares, founders' shares, or other rights, not being debt-claims, participating in profits, as well as income from other corporate rights which is subjected to the same taxation treatment as income from shares by the taxation laws of the State of which the company making the distribution is a resident; and income from arrangements, including debt obligations, carrying the right to participate in profits, to the extent so characterized under the laws of the Contracting State in which the income arises.”

## **Article VIII**

Paragraph 4 of Article 11 (Interest) of the Convention shall be deleted and replaced with the following:

“4. The term “interest” as used in this Convention means income from Government securities, bonds or debentures, whether or not secured by mortgage, and whether or not carrying a right to participate in profits, and debt-claims of every kind as well as all other income assimilated to income from money lent by the taxation laws of the State in which the income arises, including an excess inclusion with respect to a residual interest in a real estate mortgage investment conduit. Penalty charges for late payment shall not be regarded as interest for purposes of this Convention. The term “interest” also does not include income dealt with under Article 10 (Dividends).”

Paragraph 5 of Article 11 (Interest) of the Convention shall be deleted and replaced with the following:

“5. The provisions of paragraphs 2 and 3 shall not apply:

(a) if the beneficial owner of the interest, being a resident of a Contracting State, carries on business in the other Contracting State in which the interest arises through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the debt-claim in respect of which such interest is paid is effectively connected with such permanent establishment or fixed base; in such case, the provisions of Article 7 (Business Profits) or Article 15 (Independent Personal Services), as the case may be, shall apply;

(b) to an excess inclusion with respect to a residual interest in a real estate mortgage investment conduit; such an interest may be taxed in the Contracting State in which the excess inclusion arises according to the laws of that State; or

(c) to interest that is contingent interest of a type that does not qualify as portfolio interest under United States law, and to equivalent amounts under the law of Sri Lanka; if the beneficial owner is a resident of the other Contracting State, such interest may be taxed in the Contracting State in which it arises, but the tax so charged shall not exceed 15 percent of the gross amount of the interest.”

Paragraph 6 of Article 11 (Interest) of the Convention shall be deleted and replaced with the following:

“6. Interest shall be deemed to arise in a Contracting State when the payer is that State itself, a political or administrative subdivision, a local authority or a resident of that State. Where, however, the person paying the interest, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment or a fixed base or a trade or business subject to tax in that State on a net basis under Article 6 (Income from Immovable Property (Real Property)) or paragraph 1 of Article 13 (Capital Gains), and such interest is borne by such permanent establishment, fixed base, or trade or business, then such interest shall be deemed to arise in the State in which the permanent establishment, fixed base, or trade or business is situated.”

## **Article IX**

The following new Article shall be added as Article 12A (Branch Tax) of the Convention:

“Article 12A

BRANCH TAX

1. A company that is a resident of a Contracting State may be subject in the other Contracting State to a tax in addition to the tax chargeable under the other provisions of this Convention.

2. Such tax, however, may be imposed only on

(a) in the case of the United States:

(i) the portion of the business profits of the corporation attributable to a permanent establishment in the United States and the portion of the income that is subject to tax in the United States on a net basis under Article 6 (Income from Immovable Property (Real Property)) or Article 13 (Capital Gains) that represents the dividend equivalent amount of such profits or income; and

(ii) the excess, if any, of interest allocable to the business profits of the corporation that are subject to tax in the United States and attributable to a permanent establishment in the United States or to the income subject to tax in the United States on a net basis under Article 6 (Income from Immovable Property (Real Property)) or Article 13 (Capital Gains) of this Convention over the interest paid by the permanent establishment or by the trade or business in the United States under Articles 6 or 13.

(b) in the case of Sri Lanka:

(i) the portion of the business profits of the corporation attributable to a permanent establishment in Sri Lanka and the portion of the income that is subject to tax in Sri Lanka on a net basis under Article 6 (Income from Immovable Property (Real Property)) or Article 13 (Capital Gains) that represents the dividend equivalent amount of such profits or income; and

(ii) the excess, if any, of interest allocable to the business profits of the corporation that are subject to tax in Sri Lanka and attributable to a permanent establishment in Sri Lanka or to the income subject to tax in Sri Lanka on a net basis under Article 6 (Income from Immovable Property (Real Property)) or Article 13 (Capital Gains) of this Convention over the interest paid by the permanent establishment or by the trade or business in Sri Lanka under Articles 6 or 13.

3. The taxes described in paragraph 2 of this Article shall not be imposed at a rate exceeding

(a) the rate specified in paragraph 2 of Article 10 (Dividends) for the tax described in subparagraphs (a)(i) and (b)(i) of paragraph 2 of this Article; and

(b) the rate specified in paragraph 2 of Article 11 (Interest) for the tax described in subparagraphs (a)(ii) and (b)(ii) of paragraph 2 of this Article.”

## **Article X**

Paragraph 4 of Article 13 (Capital Gains) of the Convention shall be deleted and replaced with the following:

“4. Gains derived by an enterprise of a Contracting State from the alienation of ships, aircraft, or containers operated or used in international traffic or movable property pertaining to the operation or use of such ships, aircraft, or containers shall be taxable only in that State.”

## **Article XI**

Paragraph 1 of Article 16 (Dependent Personal Services) shall be deleted and replaced with the following:

“1. Subject to the provisions of Articles 18 (Artistes and Athletes), 19 (Pensions, Social Security, and Child Support Payments) and 20 (Government Service), salaries, wages, and other remuneration derived by a resident of a Contracting State in respect of an employment shall be taxable only in that State unless the employment is exercised in the other Contracting State. If the employment is so exercised, such remuneration as is derived therefrom may be taxed in that other State.”

## **Article XII**

Article 17 (Directors' Fees) shall be deleted and replaced by the following:

“Directors' fees and other compensation derived by a resident of a Contracting State for services rendered in the other Contracting State as a member of the board of directors of a company that is a resident of the other Contracting State may be taxed in that other Contracting State.”

## **Article XIII**

Paragraph 2 of Article 19 (Pensions, Social Security, and Child Support Payments) shall be deleted and replaced by the following:

“2. Notwithstanding the provisions of paragraph 1, pensions paid and other payments made under a public scheme that is part of the social security system of a Contracting State shall, notwithstanding the provisions of Article 20 (Government Service), be taxable only in that State.”

## **Article XIV**

The second sentence of Article 20 (Government Service) of the Convention shall be deleted and replaced with the following:

“However, the provisions of Articles 15 (Independent Personal Services), 16 (Dependent Personal Services), 18 (Artistes and Athletes), or 19 (Pensions, Social Security, and Child Support Payments), as the case may be, shall apply, and the preceding sentence shall not apply, to remuneration paid in respect of services rendered in connection with a business carried on by a Contracting State or political subdivision or local authority thereof.”

## Article XV

Article 23 (Limitation on Benefits) of the Convention shall be deleted and replaced by the following:

“1. A resident of a Contracting State shall be entitled to benefits otherwise accorded to residents of a Contracting State by this Convention only to the extent provided in this Article.

2. A resident of a Contracting State shall be entitled to all the benefits of this Convention if the resident is:

(a) an individual;

(b) a qualified governmental entity;

(c) a company, if

(i) all the shares in the class or classes of shares representing more than 50 percent of the voting power and value of the company are regularly traded on a recognized stock exchange, or

(ii) at least 50 percent of each class of shares in the company is owned directly or indirectly by companies entitled to benefits under clause (i), provided that in the case of indirect ownership, each intermediate owner is a person entitled to benefits of the Convention under this paragraph;

(d) a person described in subparagraph 1(c)(i) of Article 4 (Resident);

(e) a person described in subparagraph 1(c)(ii) of Article 4 (Resident), provided that more than 50 percent of the person's beneficiaries, members or participants are individuals resident in either Contracting State; or

(f) a person other than an individual, if:

(i) On at least half the days of the taxable year persons described in subparagraphs (a), (b), (c), (d) or (e) own, directly or indirectly (through a chain of ownership in which each person is entitled to benefits of the Convention under this paragraph), at least 50 percent of each class of shares or other beneficial interests in the person, and

(ii) less than 50 percent of the person's gross income for the taxable year is paid or accrued, directly or indirectly, to persons who are not residents of either Contracting State (unless the payment is attributable to a permanent establishment situated in either State), in the form of payments that are deductible for income tax purposes in the person's State of residence.

3. (a) A resident of a Contracting State not otherwise entitled to benefits shall be entitled to the benefits of this Convention with respect to an item of income derived from the other State, if:

(i) the resident is engaged in the active conduct of a trade or business in the first-mentioned State,

(ii) the income is connected with or incidental to the trade or business, and



(iii) the trade or business is substantial in relation to the activity in the other State generating the income.

(b) For purposes of this paragraph, the business of making or managing investments will not be considered an active trade or business unless the activity is banking, insurance or securities activity conducted by a bank, insurance company or registered securities dealer.

(c) Whether a trade or business is substantial for purposes of this paragraph will be determined based on all the facts and circumstances. In any case, however, a trade or business will be deemed substantial if, for the preceding taxable year, or for the average of the three preceding taxable years, the asset value, the gross income, and the payroll expense that are related to the trade or business in the first-mentioned State equal at least 7.5 percent of the resident's (and any related parties') proportionate share of the asset value, gross income and payroll expense, respectively, that are related to the activity that generated the income in the other State, and the average of the three ratios exceeds 10 percent.

(d) Income is derived in connection with a trade or business if the activity in the other State generating the income is a line of business that forms a part of or is complementary to the trade or business. Income is incidental to a trade or business if it facilitates the conduct of the trade or business in the other State.

4. A resident of a Contracting State not otherwise entitled to benefits may be granted benefits of the Convention if the competent authority of the State from which benefits are claimed so determines.

5. For purposes of this Article the term “recognized stock exchange” means:

(a) the NASDAQ System owned by the National Association of Securities Dealers, Inc. and any stock exchange registered with the U.S. Securities and Exchange Commission as a national securities exchange under the U.S. Securities Exchange Act of 1934; and

(b) the Colombo Stock Exchange; and

(c) any other stock exchange agreed upon by the competent authorities of the Contracting States.”

## **Article XVI**

1. Paragraph 4 of Article 24 (Relief from Double Taxation) of the Convention shall be deleted and replaced with the following:

“4. For purposes of allowing relief from double taxation pursuant to this Article, and subject to the limitations of the domestic laws of either Contracting State, income derived by a resident of a Contracting State which may be taxed in the other Contracting State in accordance with this Convention (other than solely by reason of citizenship in accordance with paragraph 3 of Article 1 (Personal Scope)) shall be deemed to arise in that other State.”

### **Article XVII**

Paragraph 5 of Article 25 (Nondiscrimination) of the Convention shall be renumbered as paragraph 6, and a new paragraph 5 shall be added as follows:

“5. Nothing in this Article shall be construed as preventing either Contracting State from imposing the tax described in Article 12A (Branch Tax).”

### **Article XVIII**

Paragraph 2 of Article 26 (Mutual Agreement Procedure) shall be deleted and replaced by the following:

“2. The competent authority shall endeavor, if the objection appears to it to be justified and if it is not itself able to arrive at a satisfactory solution, to resolve the case by mutual agreement with the competent authority of the other Contracting State, with a view to the avoidance of taxation which is not in accordance with the Convention. Any agreement reached shall be implemented notwithstanding any time limits or other procedural limitations in the domestic law of the Contracting States.”

### **Article XIX**

This Protocol shall be subject to ratification in accordance with the applicable procedures of each Contracting State and instruments of ratification shall be exchanged at Colombo as soon as possible. The Protocol shall enter into force upon the exchange of instruments of ratification, and shall have effect in accordance with Article 29 (Entry into Force) of the Convention.

IN WITNESS WHEREOF the undersigned, duly authorized thereto by their respective Governments, have signed this Protocol.

Done at New York this 20<sup>th</sup> day of September, 2002, in duplicate, in English. A Sinhalese language text shall be prepared which shall be considered equally authentic upon an exchange of diplomatic notes confirming its conformity with the English language text.

**FOR THE GOVERNMENT OF THE  
UNITED STATES OF AMERICA:**

**FOR THE GOVERNMENT OF THE  
DEMOCRATIC SOCIALIST REPUBLIC OF  
SRI LANKA:**